PAPER CHASE:
INTERNATIONAL PRACTICE

By **Barbara R. Hauser**

Around the Globe in 2012

A recap of notable tax and trust laws

My column's title last year was "Time to Hunker Down," and it was. Brewing above was a storm of new taxes and new required disclosures on the main front, with a few spots seeking to attract investors.

This year, I've solicited experts who practice in different countries to provide some highlights from around the globe. The big focus is still on **Switzerland**, the traditional sanctuary. Edgar Paltzer and Goran Studen, from Zurich, update us on the continued U.S. scrutiny of Swiss banks. Next, Anne Guichard gives us the report from France, which is still finding ways to encourage wealthy residents to leave and adding new taxes. Last in the European trio is the United Kingdom. Russell Cohen and Nicola Pomfret show how the UK has also found more ways to tax more people.

Leaving those principal European countries, the offshore jurisdictions are more interested in polishing their products, especially trusts and foundations. Michael McAuley reviews Guernsey and the Bahamas trust law.

Across the globe, Hong Kong has felt left behind with its rather antiquated trust law, and there's excitement about the pending modernization, as Philip Munro explains.

Finally, a smaller offshore center, Labuan, will be in the news more, as it tries to attract private funds fleeing from elsewhere (particularly Switzerland?) On the government's website is the following pitch:

> "The island of Labuan located off the Borneo coast is home to Malaysia's International Business and Financial Centre (IBFC). Labuan IBFC's position—strategically located between the two giant economies of China and India—as well as our proximity to several other regional financial centres, puts us in a unique position to tap the many investment opportunities in Asia and beyond. Sharing a common time zone with many large Asian cities makes Labuan convenient for business dealings."

Labuan plans to publish its own international private client journal beginning in 2013.

Note: The most influential global player in 2012 had to be the United States, with its aggressive Foreign Account Tax Compliance Act (FATCA) legislation, which was reported in the November issue of this magazine, and will continue to be reported by *Trusts & Estates,* especially as FATCA's various deadlines change. Under FATCA "There will be no place to go."

Barbara R. Hauser is an independent global family advisor based in Minneapolis

By **Edgar H. Paltzer** & **Goran Studen**

Switzerland

Swiss banks (still) under U.S. scrutiny

The year 2012 has undoubtedly been a rough one for Swiss banks with U.S. account holders: The oldest Swiss private bank has vanished after facing criminal charges in U.S. proceedings, and several other banks are currently under investigation in the United States. The Swiss administration is working on a global settlement with the United States, which would ideally resolve all legacy issues for the past and enable the Swiss banking industry to focus on the future. It remains to be seen whether the re-elected U.S. administration will put a global settlement on its agenda.

FATCA and Switzerland

In 2010, the United States enacted the Foreign Account Tax Compliance Act (FATCA), which introduces reporting requirements for foreign financial institutions (FFIs). In 2012, significant progress had been made regarding the signing of a cooperation agreement between the United States and Switzerland, which will presumably come into force on Jan. 1, 2014. Under the terms of such an agreement, Switzerland would agree: (1) to direct all Swiss financial institutions (which aren't otherwise exempt or deemed compliant pursuant to the agreement) to conclude an FFI agreement with the U.S. Internal Revenue Service; (2) to enable these Swiss financial institutions to comply with the obligations prescribed under FATCA rules and set forth in such FFI agreements, in particular regarding the reporting of information to the IRS, by granting an exception from Article 271 of the Swiss Criminal Code, which prohibits unlawful activities on behalf of a foreign state; and (3) to accept and promptly honor a group request by the U.S. competent authority for additional information.

New Double Taxation Treaties

While the ratification of a double taxation treaty between the United States and Switzerland is currently stalled in the U.S. Senate, in 2012, Switzerland signed double taxation treaties with, among others, Singapore, Hong Kong and the United Arab Emirates.

After approval by the Swiss parliament, the ratification of the withholding tax agreements with the United Kingdom and Austria is on track, and both agreements should enter into force on Jan. 1, 2013. On the other hand, a similar tax treaty with Germany isn't expected to come into force in the foreseeable future, due to a highly politicized debate in Germany. Finally, in autumn 2012, the draft of a revised inheritance tax treaty between France and Switzerland was presented to the broader public, triggering fierce criticism in both countries.

What Lies Ahead?

On an international level, 2013 will be heavily influenced by the implementation of FATCA, which still leaves open many questions for both the financial industry and legal advisors. Furthermore, the focus will remain on the Swiss banks, which face the risk of criminal charges in the United States.

Edgar H. Paltzer, far left, is a partner and **Goran Studen** is an associate at Niederer Kraft & Frey Ltd in Zurich

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By **Anne Guichard**

France

New trust legislation enacted and favorable tax reforms ended

France has been busy this year. It has issued new tax legislation on trusts, directed at international families. Also, the newly elected government has ended favorable tax reforms.

Two important events took place in 2012: the acknowledgment of the economic crisis and related French debt and the election of left-wing parties to Parliament.

Tax Planning

It used to be that the Parliament would issue tax acts once a year. Recently though, tax bills have been passed several times a year, making planning difficult. The trend is an increase in French taxes, including income tax, social security taxes, wealth tax and inheritance and gift tax, which are all increasingly complex and require careful and focused tax planning. In 2012, international families who are French residents and/or have French situated assets have faced the new French tax legislation on trusts adopted in July 2011, which came into force for inheritance and gift tax purposes on July 30, 2011 and for wealth tax on Jan. 1, 2012. It has caused tremendous worries for international families and innumerable questions for their trustees and advisers. The new provisions are difficult to understand and the first real tax administration guidance on the subject wasn't published until Oct. 16, 2012. The tax legislation on trusts provides for a broad definition of what a trust, a trustee, a settlor and a beneficiary are in the eyes of the French tax authorities. It applies in equal manner to inter vivos, testamentary, discretionary or not discretionary, revocable or irrevocable trusts.

For the purpose of applying the trust legislation, a beneficiary becomes a "deemed settlor" when the original settlor dies, and the second beneficiary also becomes a deemed settlor when the first deemed settlor dies, so that each generation is subjected to tax.

French inheritance tax is now to be paid on the whole trusts assets when the settlor or deemed settlor is a French tax resident at the time of his death (or gift) or when a beneficiary is a French resident at the time of death (or gift) and has been a French resident during at least six out of the last 10 years. In other cases, French inheritance tax is to be paid on only the French situated trust assets. A complex set of rules provides for different rates to apply according to the nature of the beneficiaries (descendants or not) and the array of discretion given to the trustees. This may result in descendants paying a much higher tax when assets are transferred through a discretionary trust compared to assets transferred directly to them. Tax treaties could change these results, of course.

Subject to tax treaties, the new trust legislation subjects settlors and deemed settlors to French wealth tax on the worldwide net trust assets when the settlor is a French tax resident or on French situated trust assets when the settlor or deemed settlor isn't a French resident.

A new tax called "sui generis" tax is levied. The aim of this tax is to claw back and subject, at the highest rate of wealth tax trust, assets that weren't reported in a wealth tax return. It's to be paid by settlors or deemed settlors.

The new trust legislation provides for reporting requirements by trustees, which, if not fulfilled, will trigger substantial penalties. Reporting requirements exist as soon as one of the following criteria is met:

Anne Guichard is a notaire and partner at Gilles, Ceyrac, de Buhren, Montes, Bigot, Guichard, Lucas in Paris

- the settlor or deemed settlor is a French resident on Jan. 1 of the current year, or
- one of the beneficiaries is resident in France on Jan. 1 of the current year, or
- one of the trust assets is a French-situated asset.

The trustee must report the creation or modification of an existing trust. There's also a compulsory annual disclosure requirement, which depends on the residency status of the "settlor," "deemed settlor" and beneficiaries. Failure to report and disclose is punished by a penalty of 5 percent of the trust assets with a minimum of €10,000.

End of Favorable Tax Reforms

In May and June 2012, the presidential and Parliamentary election resulted in the defeat of Nicolas Sarkozy and the election of François Hollande. The Socialist Party and other left-wing parties presently enjoy a majority in Parliament. As a result, many favorable tax reforms that had been put in place in August 2007 (after the election of then-President Nicolas Sarkozy) ended in 2012.

First, the Sarkozy government had terminated the capping system of the wealth tax (tax shield), which had been put in place in 2007. The tax shield had meant that the addition of wealth tax and income tax couldn't be higher than 50 percent of the taxpayer income. The termination of the tax shield came in exchange for a significant wealth tax rate reduction (maximum rate of 0.5 percent instead of 1.80 percent) and an increase of inheritance tax. The newly elected 2012 government kept the suppression of the tax shield, but increased tax rates to the level existing in 2007.

The previous government had raised gift and inheritance taxes in July 2011, by increasing from six to 10 years the amount of time enabling to benefit again from the tax allowances, by increasing the two highest rates (for ascendant and descendant parties) from 35 percent to 40 percent and 40 percent to 45 percent (that is, the two highest brackets are now 40 percent and 45 percent) and by suppressing the reductions that applied to gifts according to the age of the donor. The newly elected government followed this trend by increasing to 15 years the time necessary to renew the tax allowances, and by reducing by one-third the tax allowance between a parent and his child (from €159,325 to €100,000.).

Capital gains tax on real estate also has increased. Starting Feb. 1, 2012, the taper relief system (allowing larger amounts of exemption based on the length of occupancy) was amended to double from 15 years to 30 years the time necessary to benefit from a total tax exoneration, when no other exoneration is available.

> More surprisingly, non-resident taxpayers now have to pay social security taxes.

More surprisingly, non-resident taxpayers now have to pay social security taxes (15.5 percent), in addition to French income tax on their French real estate capital gains and real estate rental income, even if they don't benefit from French social security.

French residents aren't forgotten. The draft proposal for the 2013 Finance Bill increases the highest bracket on income tax to 45 percent (which amounts to 60.5 percent with the social security taxes) and creates a special additional income tax for professional income above €1 million.

French residents who would be tempted to leave still have to deal with the exit tax created in July 2011, while French residents that are tempted to hide assets in foreign bank accounts or insurance contracts and don't fulfill the yearly obligation to report to the tax administration the existence of foreign bank accounts or foreign life insurance contract face increased penalties.

By **Russell Cohen** & **Nicola Pomfret**

The United Kingdom

Changes in tax regime

In the year of the London Olympics and the Queen's Diamond Jubilee, the U.K. tax authorities certainly can't be accused of shirking work to enjoy the party. The year 2012 has seen a whole host of changes to the U.K. tax regime. Many of these will come into force in April 2013, so we anticipate another busy year ahead!

Taxation of Non-Doms

Generally, if non-U.K. domiciled individuals (non-doms) keep their income and gains offshore, they won't be subject to tax on the offshore income and gains. This is an attractive privilege enjoyed by many wealthy international individuals living in the United Kingdom.

Non-doms who have been resident in the United Kingdom for more than seven tax years must pay a charge of £30,000 to benefit from the system, whereby they're not subject to tax on their offshore income and gains. The recent rise in this charge to £50,000 for non-doms resident in the United Kingdom for more than 12 tax years may not be popular among those who pay it, but it does show a willingness by the government to accept that non-doms are an important part of the U.K.'s economic landscape and that long-term residence by non-doms is acceptable.

However, the tax benefits available to non-doms can have the effect of discouraging investment into the United Kingdom. In a positive move for both non-doms and the U.K. economy, the government has introduced business investment relief, which aims to address this. Business investment relief makes available an exemption for non-doms bringing funds to the United Kingdom to invest in trading companies.

Russell Cohen is a partner, and **Nicola Pomfret**, is an associate at Farrer & Co LLP in London

Taxation of Property

To "guarantee the fair taxation of residential property and tackle tax avoidance," the U.K. tax authorities (HM Revenue & Customs, or HMRC) have proposed new measures to raise additional funds from residential property transactions in excess of £2 million. The greatest burden will be placed on those transactions involving companies, which (in their offshore guise) have often played a key role in structuring U.K. property purchases for the wealthy.

Companies purchasing high value U.K. residential property have, since March 22, 2012, been obliged to pay stamp duty land tax (a purchase tax), at a rate of 15 percent on the full purchase price. Beginning April 1, 2013, companies will be obliged to pay capital gains tax on the sale of U.K. residential property worth over £2 million, which will put ownership by an offshore company at a disadvantage to ownership by a non-dom. Finally, beginning April 6, 2013, all non-natural owners of high value U.K. residential properties will be subject to an annual charge of between £15,000 and £140,000, depending on the value of the property. Draft legislation setting out these new measures was published on Dec. 11, 2012.

General Anti-Avoidance Rule

The general anti-avoidance rule (GAAR) is a new proposal, the likes of which has never been seen before in UK. tax law. The UK has a number of targeted anti-avoidance rules, but general anti-avoidance provisions have never been part of U.K. law. The GAAR is intended to target highly abusive and artificial tax avoidance schemes by giving HMRC the power to counteract tax arrangements that are "abusive." The

new rules are expected to take effect on April 1, 2013.

Aside from the GAAR, individuals with connections with the United Kingdom should be concerned about the possibility for damage to their reputation if the press exposes a tax arrangement as abusive. If the tax savings offered seem too good to be true, they probably are, and the reputational consequences can be very serious: A number of celebrities have suffered the ignominy of the U.K. media exposing their tax arrangements as morally wrong during 2012. It's now not just a question of how an arrangement could be viewed by a court of law, but also by the court of public opinion.

Residence Test

Historically, determining an individual's U.K. tax residence status has involved the exercise of a certain amount of judgment by the individual's advisor based on HMRC's guidance and case law. This eventually meant that the position for those leading international lifestyles became quite uncertain. In recognition of this, the government has devised a new test: the statutory residence test. This provides for individuals' residency status to be determined according to the number of ties they have to the United Kingdom, along with the amount of time they spend here: The more ties they have to the United Kingdom, the fewer days they may spend here before being categorized as a tax resident.

In the spirit of providing clarity and simplifying the classification process, HMRC has even promised an interactive online quiz for those who are unsure of their tax residency status. We anticipate, however, that those clients with complex international connections will continue to require advice on their residency status, rather than relying on their quiz results!

It's a Minefield

The numerous changes to the U.K. tax rules in 2012 will provide taxpayers and their advisors with plenty to think about over the coming months. As many of the new rules come into force this year, many clients with planning structures in place will be turning to their advisors to ensure continuing compliance with the U.K.'s complex tax rules and preserving the client's reputation in a minefield of changing laws.

By **Michael McAuley**

Guernsey and the Bahamas

The statutory landscape benefits uber-trusts

The offshore trust deal thrives.

Modern offshore trusts are quasi-agencies designed to buttress protection of the settlor and her business partner (the trustee). Over time, the trinity of settlor-trustee-beneficiary and the focus of traditional trust law—strictly for the advantage of the beneficiary—have been significantly eroded by rules frustrating creditors and promoting a general culture of paternalism and posthumous tyranny. Claims elsewhere lawful are routinely defeated by exotic conflict and jurisdictional rules. Anti-money laundering and proceeds of crime legislation, together with tax information exchange agreements (TIEAs), have been curiously ineffective in altering the statutory landscape.

The French have cottoned on to the general ineffectiveness of TIEAs. In a clever ploy, a French judge launched a criminal investigation against a trustee. The Guernsey Court of Appeal in *Re B*[1] recounted the story.

A Guernsey subsidiary of an international banking group administered two trusts. Early in 2012, a French investigating magistrate issued a summons requiring the appearance of the trustee at a pre-indictment hearing and contemplating placing the trustee under judicial investigation for possession of stolen goods and money laundering in connection with tax evasion. The trustee was eager to comply with the summons, but one of the beneficiaries objected to the provision of any information. The court of appeal confirmed that there was a general duty of confidentiality on a trustee. However, the court advised that, in certain circumstances, it's reasonable to permit a trustee to disclose information for the protection of the trustee's own interests. The trustee described the summons as a "bolt out of the blue." Have the French tax authorities given their colleagues elsewhere a new roadmap?

Also in Guernsey, a new foundation statute has been enacted and will soon be in force.[2] The Foundations (Guernsey) Law, 2012 is the latest offshore structure targeted (supposedly) at clients in civil law countries disinterested in the Crusades, the Statute of Uses and the undisciplined English law of property. The Guernsey foundation is designed for clients who don't wish prospective beneficiaries to have any rights of information until an appointed time. These beneficiaries are "disenfranchised," as the statute says. The Guernsey foundation is expected to appeal to clients of vast means, with children of such fragility that knowledge of wealth would derail a healthy upbringing. Nonetheless, eager not to foster abuse, the statute provides that a guardian be appointed to protect the disenfranchised beneficiaries' interests.

The zoo of bespoke structures has a new member—the Bahamas Executive Entity (BEE). The Executive Entities Act, 2011 (the Act), in force since Feb. 1, 2012, introduced the BEE.[3] It's a registered legal person established to perform executive functions. These functions are defined as powers and duties of any nature, including those of an enforcer, protector, trustee, investment advisor or holder of any other office. The BEE is being marketed as a vehicle to facilitate private wealth structures. Stridently anti-beneficiary, the BEE is under a statutory mandate to hold only such assets as are required to carry out its functions, and no more. In recent years, the private trustee company has dodged the unlimited personal liability of the trustee. Similarly, the Act directs a BEE trustee to remain effectively insolvent, thereby frustrating all breach of trust claims. The BEE will be copied and improved. A London law

Michael McAuley is of counsel to Carey Olsen, in St. Peter Port, Guernsey, Channel Islands

firm, the world's leading offshore jurisdiction and uber-trust provider, crafted it.

Endnotes

1. *Re B, Court of Appeal of the Island of Guernsey,* unreported judgment 35/2012 (July 7, 2012), available at *www.guernseylegalresources.gg/article/99767/2012.*
2. The Foundations (Guernsey) Law, 2012, available at *www.gov.gg/CHttpHandler.ashx?id=75647&p=0).*
3. The Executive Entities Act, 2011 (Bahamas), available at *www.bfsb-bahamas.com/res-legislation.php.*

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By **Mimi Hutton** & **Philip Munro**

Hong Kong

The reform of the Trustee Ordinance

Hong Kong has remained an important center for private wealth management since its return to Chinese sovereignty. This is in large part because its position under the People's Republic of China's "one country, two systems" rule has preserved its favorable tax regime (which allows Hong Kong to be used as a tax-neutral jurisdiction in many situations) and its separate legal system derived from English law. Hong Kong trusts aren't popular in recent years, because Hong Kong's trust law isn't as flexible as that in force in traditional offshore jurisdictions. Hong Kong's trust law has, however, recently been reviewed, and it's likely to be modernized in the near future.

Trust Law

The Hong Kong trust law is contained, in large part, in the Trustee Ordinance, enacted in 1934. The statute is largely modeled on the English Trustee Act of 1925, although it was amended in 1970 by the Perpetuities and Accumulations Ordinance to modernize the previous common law rule against perpetuities.

The settlor of a Hong Kong trust isn't required to be a Hong Kong resident. There's no minimum trust fund, and trust instruments don't require registration. Hong Kong trusts may be established for the benefit of beneficiaries or in the furtherance of charitable purposes; they can be revocable or irrevocable. Hong Kong trust law doesn't recognize non-charitable purpose trusts. Hong Kong trusts are allowed a fixed perpetuity period of up to 80 years; a number of different accumulation periods are permitted, including the lifetime of the settlor and 21 years following the settlor's death.

Trustees of Hong Kong trusts have the power to invest in the permitted investment types that are set out in Schedule 2 of the Trustee Ordinance. It's possible (and a relatively typical practice) to draft a trust instrument to opt out of the investment restrictions in Schedule 2.

Consultation on Revision

The Hong Kong Financial Services and the Treasury Bureau (FSTB) announced in 2008 that it would revise Hong Kong's trust law. In addition to addressing some of the uncertainties in the existing law, the FSTB was keen to promote the use of Hong Kong's trust law in a bid to further develop Hong Kong's position as a global asset management center.

The FSTB began a public consultation on the review of the trust law on June 21, 2009. The consultation ended on Sept. 21, 2009, and consultation conclusions and initial proposals for legislative reform were issued in February 2010. These proposals were refined further following a second public consultation that began in March 2012. The Hong Kong government has now produced a draft bill likely to be laid before the Hong Kong legislative committee (LegCo) in the Spring of 2013.

Key Proposals and Conclusions

A number of significant proposed amendments to the Hong Kong Trustee Ordinance will be incorporated in the draft legislation to be considered by LegCo, including:

1. **Rule against remoteness of vesting**. The Perpetuities and Accumulations Ordinance would repeal the existing rule against perpetuities for new trusts. If this change is made, new Hong Kong trusts will be capable of perpetual existence.
2. **Accumulations of income.** The Perpetuities and

Mimi Hutton is a partner and **Philip Munro** is an associate at Withers, Hong Kong

Accumulations Ordinance would repeal the rule against excessive accumulations (except in relation to charitable trusts) for trusts created after the effective date of this legislative change.

3. **Forced heirship**. Express provision would be made so that forced heirship rules don't affect the validity of a Hong Kong trust.
4. **General powers to assist trustees.** The trustees of a Hong Kong trust would be given a general power to appoint agents, nominees and custodians and to charge and insure trust property, even if a trust instrument doesn't expressly confer these powers on them.
5. **Trustee duty of care.** LegCo will consider introducing a statutory duty of care for trustees into Hong Kong law, as was implemented in England and Wales in the Trustee Act 2000.
6. **Non-charitable purpose trusts.** Consultation process participants were asked whether Hong Kong should follow other offshore jurisdictions and legislate to allow for the creation of non-charitable purpose trusts. Although many participants suggested that there would be merit in Hong Kong allowing for the creation of non-charitable purpose trusts, this proposal was deferred for the time being pending further study.

The Future

LegCo must first approve these proposals before they become operative. Should the process of obtaining legislative approval begin soon, the proposals would likely become law (in whole or part) during this year. Hong Kong is hoping that, following the revision of its Trustee Ordinance, it will become a jurisdiction of choice for the implementation of trust structures in Asia and in the Chinese language. The proposals look set to incorporate some of the typical modern provisions into the Trustee Ordinance, so that Hong Kong will not only be in an improved position to offer trusts to Asian families, but also should also be able to attract more international trust business from settlors outside Asia.